

Memorandum for

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Deputy Director for
Intelligence Programs
NSC Staff

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Attached, as requested, is a quick look at Summit country attitudes/positions on potential energy actions in response to the Persian Gulf situation. If we can be of further assistance to you or to Bill Martin, please call me [redacted] or [redacted] Chief, Strategic Resources Division, Office of Global Issues [redacted]

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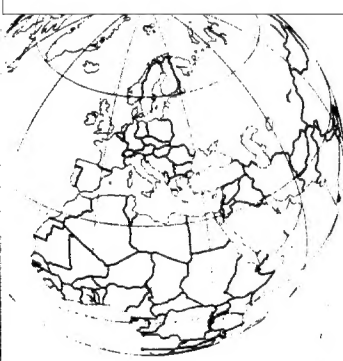
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Chief,
Western Europe Division

E U R A

Office of European Analysis
Directorate of Intelligence



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Spot Market Monitoring

[redacted] the volume of oil traded in the spot market or in spot type transactions has increased markedly in the past year or two. Some estimates indicate that as much as 20 percent of oil is now traded in spot transactions. While we doubt the figure is that high, we believe it is considerably higher than the 3-5 percent level that prevailed in past years. Much of the increase in spot transactions represents the erosion of market share of the major companies, increased marketing by national oil companies and a reduction in the number and length of term contracts. [redacted]

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Monitoring individual transactions in the spot market is difficult because details of many transactions go unreported and the same cargo may change hands several times before final delivery. Price quotes are readily available and are reported daily in the press such as Platt's Oilgram. The futures market is also a good indicator of trends in spot prices. [redacted]

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Government policies will also be a key indicator of spot activity because of the proliferation of state-owned or controlled companies in many of the consuming countries. The French, for example, have encouraged spot purchases in the past by CFP when oil supplies were disrupted. Japan has also encouraged its companies to engage in spot purchases. In 1983, Tokyo relied on the spot market to supply about 18 percent of total oil needs. [redacted]

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Demand Restraint Monitoring

Our ability to monitor the effectiveness of demand restraint measures in foreign countries is very limited and we have some concerns regarding the ability of anyone to get an accurate and timely measure of a reduction in oil use. To measure the effectiveness of demand restraint measures an estimate of pre-crisis demand--a baseline against which demand reductions would be measured--is required. In most instances, we believe countries will purposely inflate the demand projections to make the restraint measures appear more effective than they actually are. [redacted]

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Refinery sales is the best available indicator of oil use. Data for these sales, however, is often 2-3 months old by the time it can be aggregated and made available. The IEA reporting system can provide a more timely estimate of oil sales but is not an accurate measure of actual consumption because it reflects

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intentions rather than actual use. The data problem is further compounded by lack of reliable information on secondary and tertiary stocks. Implementation of demand restraint measures might cause consumers to use these stocks initially rather than cut oil use. Such a decision would cause a reduction in refinery sales and make it appear that the demand restraint measures were effective when in reality, end users had not cut back on oil consumption. [REDACTED]

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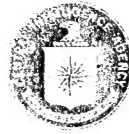
Major Developed Countries:
Oil Stock Situation
31 March 1984

	Oil Consumption 1983 Million b/d	Million Barrels			Days of forward consumption		
		Total Stocks	Government- Owned	Commercial	Total	Government- Owned	Commercial
United States	15.2	1463	392	1071	96	26	70
Canada	1.3	114	0	114	88	0	88
Japan	4.3	408	90	319	95	21	74
France ^a	1.8	150	0	150	83	0	83
Italy	1.7	169	6 ^b	163	99	4	96
United Kingdom	1.5	119	0	119	79	0	79
West Germany	2.2	269	55	214	122	25	97

a) Data for yearend 1983

b) Assumes no increase in government-owned stocks since yearend 1983.

Central Intelligence Agency



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

31 May 1984

Summit Countries: Views on Response to an Oil Supply Disruption

The other Summit countries generally agree in principle on the desirability of a coordinated response to a disruption of Persian Gulf oil supplies. Their views on specific issues are sufficiently different, however, that we doubt a significant agreement on cooperation can be worked out soon. In particular, West Germany and France are opposed to a policy of early drawdowns of government oil stocks. There is probably greater unanimity of opinion on the dangers of a sudden rush to line up spot oil contracts, but even here some countries--especially Italy--are reluctant to limit their freedom of action in advance. In an emergency the actions of the four West European Summit countries will be strongly influenced by their participation in the EC's oil crisis machinery--which emphasizes demand restraint rather than stock drawdowns. [REDACTED]

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Japan

Tokyo was considering permitting early release of oil stocks in a supply disruption even before US Ambassador Fairbanks went to Tokyo in May and outlined Washington's support of early and coordinated stock drawdowns. The Japanese are unsure when their review of oil crisis policies will be completed but have promised to take US preferences into account. Ambassador Fairbanks' discussions with Foreign Ministry officials made clear the Japanese belief that to be effective at calming spot markets, an early stock drawdown scheme must be relatively specific and publicized in advance. Officials in Tokyo have also indicated that individual countries should have the option of using demand restraint measures prior to drawdowns since not all countries have stocks as large as the United States. [REDACTED]

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The Japanese Government and oil industry have been fairly optimistic in recent months about their country's ability to cope with a cutoff of oil from the Persian Gulf. Oil stocks in Japan are high, reducing oil companies' incentives to engage in panic buying on the spot market. Also contributing to Japan's relaxed attitude are seasonally low energy demand and the general softness in the world oil market. As a result, Japanese oil companies believe at least half of any Gulf-related shortfall could be offset by boosting purchases from Indonesia, Mexico, and Africa. A Foreign Ministry study done in December indicated that even without heightened conservation efforts or increased oil supplies from other sources, Japan had enough oil stockpiled to last 215 days; the US Embassy noted, however, the study failed to take account of operational stocks as well as price factors. []

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Japanese optimism has waned somewhat following stepped-up attacks on ships in the Persian Gulf. On 26 May, Japanese shipowners and the All Japan Seaman's Union agreed to indefinitely suspend sending Japanese oil carriers and cargo vessels into the northern part of the Gulf. Nonetheless, with inflation running at 3 percent and a projected 1984 current account surplus of \$25 billion, Japan is in a better position than most countries to absorb oil price rises that may result from an escalation of hostilities in the Gulf. []

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Canada

Oil imports from the Persian Gulf--around 50,000 b/d last year--currently account for less than 4 percent of total Canadian consumption. Nonetheless, in response to the escalation of the Iran-Iraq War, Ottawa began interagency contingency planning in March to prepare for an oil shortage. Canadian production is near capacity, so little incremental oil would be available. Ottawa maintains no strategic oil stockpile, but commercial firms hold about 90 days reserves. Ottawa has the power to allocate these reserves upon declaring an emergency situation. []

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Ottawa is concerned mainly with keeping oil prices from rising rapidly and would advocate dampening price increases through timely release of strategic reserves by those countries holding them. On the other hand, Ottawa would try to limit its own activity to IEA programs and would not immediately order commercial stock drawdowns. Trudeau's traditional concern for the welfare of Third World economies would likely prompt Ottawa to urge measures to aid the LDCs. []

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European Community

EC Commission officials and energy ministers continue to downplay the possibility of a severe disruption of petroleum supplies from the Persian Gulf as a result of the Iran-Iraq War, even though Commission officials determined last December that a cutoff of Gulf oil would result in a shortfall of 1 to 1.5 million b/d for the Community--between 12 and 18 percent of EC consumption. Commission officials discount a major oil supply crisis, according to the US Mission to the European Community, because they believe:

- o Any disruption will be shortlived.
- o The United States will keep the Straits of Hormuz open.
- o Existing stocks--including floating Saudi storage--provide a comfortable cushion.
- o Saudi Arabia will increase production, if necessary, to maintain current prices for crude oil.

EC Energy Ministers discussed Persian Gulf developments at their meeting on 22 May and concluded that continued conservation efforts, market conditions, and the level of existing stocks "provide the necessary means to cope with the situation."

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The EC's emergency plans for dealing with a potential interruption of oil supplies emphasize consultation, coordinated demand restraint, and intra-Community trade actions to minimize oil price fluctuations. The Community's oil crisis machinery has three key elements:

- o Mandatory national stocks equal to at least 90 days average consumption (based on the previous calendar year).
- o A three-phased system to reduce oil consumption and reallocate supplies among EC members that is compatible with but independent of the IEA system.
- o Export licenses for intra-EC shipments of petroleum and petroleum products to maintain stability within the Common Market.

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The Petroleum Supply Group (PSG)--consisting of experts from each of the ten EC countries--coordinates EC policy during an oil crisis. EC members must inform and consult with both the Commission and the PSG before oil stocks are drawn below the compulsory limit. In our judgment, most EC members believe coordinated demand restraint measures add greater stability to the global oil market than manipulation of emergency stocks. Consequently, we think the EC countries are unlikely to agree to draw down existing oil stocks except under the most dire circumstances. According to State Department reports, France, in particular, believes drawing on emergency oil stocks is a measure of last resort. [REDACTED]

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West Germany

[REDACTED]

Bonn backs the principle of equitable burden sharing and considers the IEA to be the best coordinating mechanism for joint action. However, West Germany will seek to delay implementation of the IEA sharing system as long as possible. Before agreeing to IEA-backed plans, the Kohl government will want to assess carefully the severity of the crisis and the likely market response to measures such as a release of stocks. Although petroleum stocks are currently in excess of 120 days of consumption--well above the agreed 90-day floor--Bonn does not want to resort immediately to drawing down stocks. Instead, the government prefers initially to use restraints such as limits on speed and weekend driving, and to permit prices to rise to ration the reduced oil supply. Bonn likely would be willing to contribute to a plan to ease the impact of an oil crisis on the LDCs, but will expect the costs to be shared equitably. [REDACTED]

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France

French dependence on oil--particularly imports of Persian Gulf crude--remains high although it has dropped significantly since 1973 due to increased use of nuclear power and natural gas. French officials apparently agree on the need for a collective Western response to a major disruption of Gulf oil supplies. In particular, they believe the major countries should not rush to buy oil on the spot market, as this would only push up prices unnecessarily. Nevertheless, they are still not willing to participate directly in any IEA coordination effort but rather will act through the European Community. In addition, any coordinated response must be seen as an attempt to deal with an actual shortfall and not as an exercise in "OPEC busting." [REDACTED]

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Paris would prefer that the first reaction to an oil market disruption be in the form of demand reduction. Stocks, in the French view, are a second line of defense that will last longer for essential needs if demand reduction is the major response. If the initial shock were small and clearly temporary, however, reducing stocks could be sufficient without cutting demand. In any event, the decision to draw down oil stocks would have to be coordinated with the other EC countries. [REDACTED]

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Italy

At the first sign of a supply crunch, the Italian Government would consider drawing down its reserves, including its strategic stocks, if other countries agreed to do the same. Rome has had a longstanding interest in the early use of stocks and believes that such a policy is preferable to immediate imposition of demand restraints. While conforming as much as possible to any international cooperative effort, Rome would still seek to protect its national interests. For example, Rome does not favor--even in concert with others--exerting pressure on oil companies to stay out of the spot market because this would restrict Italian supply flexibility. In the past, Rome has limited itself only to recommending that companies utilize the spot market on a programmed and nondiscriminating basis--but only to avoid unexpected price increases. [REDACTED]

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On the domestic side, Rome probably would return to a greater emphasis on diversifying Italian energy supplies. Demand restraint measures probably would focus on gasoline consumption and include lower speed limits, increased taxes, and limited driving hours on Sundays and holidays. If rationing were to become necessary, oil supplies would be allocated away from "nonessential" users. [REDACTED]

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United Kingdom

London probably would support Washington's oil stock policy in the event of an oil supply disruption. Nevertheless, the Thatcher government would prefer an early triggering of the IEA sharing mechanism--especially if the crisis appears likely to be prolonged--as a show of international unity and to create an atmosphere that will divert pressure from the United Kingdom--a net oil exporter--to assist in bilateral oil supply efforts by drawing down its oil stocks. British oil production is currently near full capacity and could not be substantially increased in response to a crisis. A primary British concern is to maintain market stability and to avoid recourse to spot market purchases which would drive up oil prices. Government officials fear that higher oil prices and increased uncertainty in the oil market would aggravate LDC debt problems and slow the worldwide economic recovery. London's concern to preserve the recovery also is evident in its reluctance to impose demand restraint or conservation measures, which would threaten industrial production. [REDACTED]

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